No. 4091

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

J. J. RAUER,
Appellant,

vs.

GEORGE H. HATFIELD, as trustee in bankruptcy of the estate of A. E. BUCKMAN, bankrupt, and H. M. WRIGHT, et al.,
Appellees,

and

J. J. RAUER,
Appellant,

vs.

GEORGE H. HATFIELD, et al.,
Appellees.

BRIEF FOR APPELLEE, GEORGE H. HATFIELD, AS TRUSTEE IN BANKRUPTCY OF THE ESTATE OF A. E. BUCKMAN, BANKRUPT.

EDWIN H. WILLIAMS,
CHARLES S. WHEELER, JR.,
Attorneys for Appellee, George H. Hatfield, as Trustee in Bankruptcy of the Estate of A. E. Buckman, Bankrupt.

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Introduction.

In this brief we shall not discuss the question raised by appellant as to the propriety of the compensation awarded the Master. We shall also ig-

nore, as unworthy even of comment, the ridiculous claim that the Master was disqualified. We shall confine our attention to the first appeal mentioned in appellant's brief (see Aplt. Op. Br. p. 10), viz: the appeal taken from the so-called "interlocutory" decree and also from the final decree rendered in the Court below. As to the final decree, said appeal involves questions as to the Master's rulings upon an accounting had between Rauer, the appellant, and the above named plaintiff and appellee. With reference to the so-called "interlocutory" decree, the appellant attempts to raise certain questions as to the right of the plaintiff and appellee to take possession of the assets of Sunset Construction Company, a purported corporation.

As we shall point out later in this brief, the so-called "interlocutory" decree is in truth a final decree as to all matters covered thereby (except the settlement of accounts), and, since said decree was rendered many years before this appeal was taken, the appeal therefrom should be dismissed or at least all questions raised in connection therewith should be ignored, upon the ground that the time to appeal therefrom has long since expired.

We feel that it is necessary for us to make a full statement of the facts in this brief, as the statement made by appellant well merits the same comment earned by a former statement made by appellant before the Master in Chancery when the latter said (Tr. p. 75):

"This is a very mistaken and reckless statement of facts."

Statement of Facts.

The plaintiff and appellee, Buckman's trustee in bankruptcy, filed a bill in equity for two purposes: First, he sought to secure a decree holding that all of the assets of Sunset Construction Company were in reality the property of A. E. Buckman (Tr. p. 3), and, second, he sought to have the transfer of the capital stock of Sunset Construction Company from Buckman, through Rauer, to one Meadows, set aside on the ground of fraud.

During the trial it was brought out that there was not *one* Sunset Construction Company, but *two*. The first corporation of that name was organized by A. E. Buckman with the assistance of several dummies. Its charter was forfeited in December, 1911, for non-payment of its franchise tax. Early in the existence of this corporation certain of its stock were issued. Three shares were issued merely to qualify directors. These shares were actually owned by A. E. Buckman. The only other stock issued (10,150 shares), was issued to A. E. Buckman and pledged by him to Rauer. This is the stock referred to in the pleadings and in the evidence. No stock was ever issued in Sunset Construction Company No. 2.

The two Sunset Construction Companies, both mere naked forms, were dominated and owned absolutely by A. E. Buckman. After the charter of the first Sunset Construction Company had been forfeited, the second corporation of the same name was organized,—Buckman naming the same directors. (Tr. pp. 224-225.) It was planned to issue stock in the new corporation to substitute for the stock of the defunct corporation, but this was never done. Stock was filled out in part, but the new certificates were never signed by the secretary and were never issued. They were left intact in the stock certificate book. (Tr. pp. 224-225.)

Counsel make the astounding claim (see Aplt. Op. Br. p. 30) that the only evidence introduced in this record by the parties

> "is directed simply and solely to the question of the ownership of the shares of stock pledged by Buckman to Rauer, and by Rauer sold under the pledge to Meadows,—the Trustee claiming these shares should pass to the estate, and the defendants insisting that the sale was made under a valid pledge."

The transcript fairly teems with testimony on the subject of Buckman's ownership of all of the assets of Sunset Construction Company No. 2, the only living corporation. For example, attorney W. H. Chapman, who organized Sunset Construction Company No. 2, testified as follows (Tr. p. 227):

> "The stock of the corporation was not issued to Mr. Buckman but he was the incorporator

> of the corporation *and the owner of the assets.* I don't think we had any stockholders' meeting except the original meeting of the stockholders to adopt the by-laws. That is the only stockholders' meeting they ever had." (Italics ours.)

A. E. Buckman, the bankrupt, also testified (Tr. p. 230):

> "I was the incorporator of the company and owned the stock. All of it. Although it stood in the name of people as trustees, I owned the stock, was supposed to own it.'

Filmore Buckman testified that A. E. Buckman was president and general manager of the corporation and that he drew as much money from it as he desired. Often he would not even take the trouble to account to his bookkeeper at all for moneys spent. He used them for expenses, *which included personal living expenses.* (Tr. pp. 210-211.)

Filmore Buckman says:

> "There was no fixed amount that Mr. Buckman was allowed for expenses. Sometimes it ran into the neighborhood of $500 a month in carrying on the business. * * * Mr. Buckman took whatever money he needed from time to time. He was naturally managing the business. * * * By personal expenses I mean expenses for his own personal use,—that is, living expenses."

Clearly "Sunset Construction Company No. 2" was a mere alias for Buckman, a bankrupt, and

Sunset Construction Company No. 1, which served a like function, was altogether out of existence. Sunset Construction Company No. 2 issued no stock, it held no formal meetings and its purported directors were the confessed dummies of A. E. Buckman. It was a mere cloak to shield Buckman's activities,—activities in which Rauer was a very energetic participant.

The purpose of their connivance is brought out significantly by a Mrs. Louise Brown, one of Buckman's creditors, whose testimony stands in the record without contradiction. (Tr. p. 234.)

> "Mr. Buckman stated to me in reference to my claim that before he would pay my claim he would see me in Hell first,—before I would get one dollar of his money. He also said he would go through bankruptcy, and would even go to State's prison before he would pay me * * *. Mr. Buckman hears me and knows that I speak the truth."

Rauer's connivance with Buckman commenced sometime in March of 1911. At that time he started lending money to "Sunset Construction Company No. 1",—in reality to Buckman. When that company became defunct, he had advanced to it (i. e. to Buckman) some $19,000. (Tr. pp. 241-245-247-248.) All of this indebtedness was eventually paid up by securities placed in his hands by Buckman.

In January 1914, Rauer held a note for $15,000, which had been given him by W. H. Chapman to

represent the balance of indebtedness due him, Rauer, from Company No. 1 and which had not been fully liquidated through the sale by Rauer of the securities held by him. There had been received by Rauer a credit of $6734.16 which he applied upon this indebtedness prior to January 1914 (Tr. pp. 241-247), but neither this nor any other credit was ever endorsed upon Chapman's note. In January 1914, Rauer took the note of Buckman for $20,000 which covered the same indebtedness as the Chapman note already executed, as well as certain additional sums claimed to be due from Company No. 2. (Tr. p. 278.) By executing this latter note Buckman acknowledged his liability as an original debtor both for the balance due Rauer from Sunset Construction Company No. 1 and for the amount then due from Sunset Construction Company No. 2, Rauer accepting said note as additional security upon the indebtedness of the Sunset Construction Company. He so alleges expressly in his answer and so testified under oath. (Tr. p. 273.)

Before the Master, Rauer testified as follows (Tr. p. 278):

> "Q. Why was it, you took that note executed by A. E. Buckman instead of having it executed by the Sunset Construction Company?
> A. There was really no reason for it. *He was really the whole shooting match.*"

(And yet counsel find it possible to state again and again in their brief that Rauer, in his inno-

cence, never knew that Buckman and his company were one and the same!)

Thereafter, Rauer in the name of an admitted dummy, one Wehrle, took a chattel mortgage from Sunset Construction Company No. 2 to secure two notes, one for $5000 and the other for $10,000. (Tr. pp. 272-3, 278-9.) These notes Rauer says secured the same indebtedness as the others from Chapman and Buckman which he already held. (Tr. p. 273.) But Rauer was insatiable. As "additional security" he had Buckman write him out checks in the name of Sunset Construction Company which he held without cashing (Tr. p. 282), as all of the parties involved knew there were no funds in the bank to meet them.

So, at one and the same time (i. e. the time of bankruptcy), Rauer held:

Note of Chapman for	$15,000.	
Note of Buckman for	$20,000.	
Notes of Sunset Construction Co. aggregating,	$15,000.	
Checks of Sunset Construction Co. aggregating	$20,584.95	$70,584.95

Rauer's account filed with the Master claimed on the date of Buckman's bankruptcy that there was due him a total of $33,084.95. (Tr. p. 256.) Even this was many thousands of dollars in excess of what the Master found that Rauer was justly entitled to receive on that date. Yet Rauer held all of these instruments, without the endorsement of a

single credit upon any one of them,—save only the credit for $7500 endorsed on the notes of the Sunset Construction Company which was later cancelled by Rauer.

From the foregoing it is clear that Rauer was well aware that Buckman and Sunset Construction Company were identical and that he was conspiring with Buckman to cover up Buckman assets by receiving duplicate evidences of the same indebtedness and taking liens on every shred of property which Buckman held or possessed. It was only after a rigid and prolonged inquiry that it was disclosed that all of these apparently valid and separate obligations covered one and the same indebtedness.

Rauer finally admitted (Tr. p. 273):

> "I held three promissory notes and they represented the same indebtedness, but I held different collateral. I collected interest at 1½% a month for a time up to the execution of the note for $20,000 and afterwards at the rate of 2% a month."

(It may be remarked in passing that the extraordinary interest charges indicated in the foregoing testimony afford some answer to counsels' query (see Appl. Br. p. 28) as to how Rauer benefited by his part in the conspiracy.)

In this case, there is ample evidence reflecting generally upon appellant Rauer's trustworthiness. There is positive evidence that Rauer testified to what was not true in a number of instances where

the testimony pertained to facts of crucial importance. The attempt of a party defendant to cover up the truth by giving false testimony upon material issues is always strong evidence of culpability. Here we deem it an important factor in establishing the fraudulent nature of Rauer's dealings with Buckman and the utter unreliability of the testimony of either of these parties.

It has already been shown that Rauer held Buckman's paper witnessing an indebtedness far in excess of the true amount due him. His excuse was that he took the duplicate evidences of indebtedness for the purpose of affording himself "additional security". But what means did Rauer take to establish the true amount due him? None of the notes or checks witnessed on their face that the indebtedness which they evidenced was already represented by other instruments. No such statement is made in any other document introduced in evidence. We were forced to seek the true amount due Rauer from his own testimony on cross-examination, and from a careful analysis of his accounts.

Rauer's sworn answer expressly alleges (Tr. p. 11):

> "At various times balances were struck between said J. J. Rauer and said Sunset Construction Company and said balances at various times were as follows: * * *
>
> On December 6th 1913 the sum of $20,000."

Rauer's account offered in evidence and sworn to by him as a true statement of account shows that the amount due to Rauer on December 3rd, 1913, was $31,460.50. (Tr. p. 255.) There were no transactions between Buckman and Rauer et al. between this date and December 6th.

Rauer testified as a witness (Tr. 243) that the correct amount due him on December 3rd, 1913 was $20,000. Later (Tr. p. 272), Rauer testified that on December 12, 1913, the Sunset Construction Company owed him a note for $20,000 and two unpaid checks, one for $8260 and the other for $3000. His account shows no transaction between the dates of December 3, 1913, and December 12, 1913.

Filmore Buckman testified that there was only one check for $8260 and that check was executed in the spring of the following year,—May 20th, 1914. (Tr. p. 296.) He testified, further, that the ledger sheet of the Sunset Construction Company shows that the corporation owed Rauer $21,490 on December 26, 1913. (Tr. p. 298.)

In regard to the matter of interest, Rauer denied specifically that he collected any interest whatever from the Sunset Construction Co. during the year 1914, and testified (Tr. p. 273):

> "I did not collect $400 a month interest on the $20,000 note. I never got a ten cent piece interest on that note."

Thereafter a series of checks were introduced in evidence which showed very large payments

made to Rauer between May 31, 1913 and April 6, 1915 (Tr. p. 274), and it was stipulated (Tr. p. 295), that these checks included payments of interest to Rauer amounting to the sum of $6619.

Rauer's account, which was sworn to by him as correct, shows no payments whatever received by him between the dates of November 10, 1913 and July 15, 1915 (Tr. pp. 255-256), but the list of checks last above referred to prove conclusively that he received approximately $23,000 in coin between the dates mentioned.

Rauer swore in an affidavit filed in the matter of Buckman's bankruptcy that he had loaned the Sunset Construction Co. an aggregate of some $105,615.84 up to March 15 (Tr. 284), "upon which there has been paid back to affiant up to that said last date, the sum of $76,741.02, leaving a balance due of $28,874.82". This allegation is supported by two other sworn statements made by Rauer (Tr. p. 283), and other corroborating evidence. (Master's Report, 25.) Yet his account submitted to the Master showed less than $61,000 in credits received by Rauer up to the time mentioned. Rauer was asked (Tr. p. 284):

> "Is there any explanation which you want to make why the amount that you have credited in the account to Sunset Construction Co. is some $16,000 less than the amount that you have stated in your affidavit was paid by the Sunset Construction Co. prior to March 15, 1915?
>
> A. I will have to run over the statement and see."

Rauer was later recalled but gave no explanation.
The Master (Tr. p. 284):

> "The point is that you file an account with no vouchers at all. I presume that if I had examined this carefully I would have thrown this account out in the first place." * * *

The foregoing are merely a few of the glaring instances of efforts made by Rauer to deceive the Court. His account was confused by incorrect dates, by incorrect names, and also through the simple expedient of omitting material items; and, in more than one case, he resorted to the segregation of a single transaction into numerous items, scattering them broadcast through a very long account. His whole effort at the trial of this action was to confuse the issues and conceal the truth. We firmly believe that the tactics to which he resorted were in large measure successful, and that the judgment against him represents but a mere fraction of what is truly due from him to Buckman's trustee. Judge Van Fleet was evidently cognizant of this fact when, in his oral opinion, he said:

> "The Master, I think, if he committed any error, committed it against the parties prevailing as to the extent of the accounting required."

In closing this statement of the dealings between Rauer and Buckman, and before taking up the so-called "interlocutory" decree and the accounting had pursuant thereto, we should perhaps call the

Court's attention to one further matter. At page 3 of appellant's brief we find the following:

> "None of the creditors of Sunset Construction Company filed any claims against the Bankrupt's estate, nor was any notice sent to those who had dealings with Sunset Construction Company and a nominal bond in the sum of $100 was given by the Trustee elected by the creditors who were limited as before stated to those who had done business with Buckman individually."

Obviously Rauer's purpose in making the foregoing statement in his brief is to create the impression in the mind of this Court that, in holding Sunset Construction Company a mere instrumentality of Buckman, and the assets of that company Buckman's assets,—an injustice has been done to innocent creditors of Sunset Construction Company. Rauer's own testimony affords the best answer to this suggestion. At page 364 of the transcript will be found his unqualified assertion that he, personally, was the only creditor of Sunset Construction Company. (See, also, the same assertion in appellant's brief, page 27.) Furthermore, even were the fact otherwise, the "interlocutory" decree would not work an injustice upon Buckman's creditors who dealt in good faith with "Sunset Construction Company".

Assuming that Sunset had creditors other than Rauer at the date of Buckman's bankruptcy, there is no reason why the bankruptcy Court should not, in the exercise of its equity jurisdiction, permit

such claims to be proved and allowed in the estate in bankruptcy of A. E. Buckman, to be paid in due course of administration.

The Special Master suggests the exercise of this very power with regard to Rauer's claim against Sunset Construction Company and, while we sincerely disagree with the Master as to the propriety of any such proceeding in *Rauer's* case, we nevertheless concede that, in any proper case, this procedure should be followed. At any rate, Rauer is in no position to complain.

As to the fact that Sunset Construction Company No. 2 was never formally declared a bankrupt: In view of the fact that it has been determined that all of the property of Sunset Construction Company No. 2 belonged to the bankrupt and passed to his trustee, there is no reason why said corporation should have been formally declared a bankrupt. Indeed, such procedure would have been wholly unsound, since it would involve a contradiction in terms. A Court of equity, looking through form to substance, has ascertained that the corporate form must be disregarded entirely; that Buckman and his dummy company were one and the same. Therefore, the decision of the Court,—followed to its only possible conclusion,—must mean that all creditors of the so-called Sunset Construction Company (assuming the existence of such creditors), were Buckman's creditors. Hence, Buckman's bankruptcy was the only bankruptcy that could exist in

the premises, in so far as all of these creditors were concerned.

THE SO-CALLED "INTERLOCUTORY" DECREE.

The nature of the inquiry on accounting before the Special Master in Chancery was obviously measured and defined by the express terms of the "interlocutory" decree by which the accounting was ordered. There is no possible ambiguity in this decree.

In view of the pleadings in this case, it is difficult for us to understand how appellant's counsel can claim at this time that the ownership of stock and the accounting as to its value is the only issue covered by the decree. Counsel evidently concede that the decree must be construed in the light of the pleadings and evidence. However, counsel's interpretation of the decree is blasted by this same record.

The suit is in equity and it is alleged in the bill that the corporation

> "amounted no nothing more and has amounted to nothing more than the placing in a corporate form of the capital of said Buckman and his abilities as a General Construction Contractor",

and that

> "said corporation was formed and organized as a covering for the activities and operations of said A. E. Buckman under the form and legal entity and name of said corporation".

Furthermore, counsel to the contrary notwithstanding, it is also alleged, not only that Rauer conspired with Buckman in the matter of the transfer of shares, but that Buckman and other persons, *including J. J. Rauer,* operated and carried on the corporation and its business for the benefit of each of them, and that they received the profits thereof. We respectfully refer the Court to paragraph VI of the bill for substantiation of this statement.

The second paragraph of the decree decides that A. E. Buckman, at the time of his bankruptcy, was the *owner* of all of the *property,* etc. of Sunset Construction Company and that at said time all of said *property, etc.,* vested in and became the property of Buckman's trustee. The third paragraph orders the defendants, including J. J. Rauer, to account for all moneys and property received by them from Sunset Construction Company *since the 13th day of December, 1911.* This date was the date of the incorporation of Sunset Construction Company No. 2. Since the *first* Sunset Construction Company had forfeited its charter long prior to December 13th, 1911,—not only the date of the incorporation of the second company, but also the express date from which the accounting was ordered to commence,—*this accounting is alone concerned with the activities of A. E. Buckman and Sunset Construction Company No. 2.*

In directly adjudging A. E. Buckman, bankrupt, the owner of Sunset Construction Company No. 2

and of all of its property and assets the decree determines definitely that, in the eyes of Equity, A. E. Buckman and Sunset Construction Company No. 2 were identical. The eleventh-hour claim of appellant Rauer that the decree merely declares Buckman's trustee the owner of certain corporate stock of Sunset Construction Company could not be more clearly refuted than by the terms of the decree itself. Furthermore, if Rauer's present contention were correct, the decision of the Court that the *property* of the second company *belongs to the bankrupt's estate,* would have constituted a gross disregard of established legal and equitable principles.

Bauernschmidt v. Bauernschmidt, 60 A. (Md.) 437;

Peckett v. Wood, 234 Fed. 833 at 838;

United States, etc., Trust Co. v. Delaware Western Construction Co., 112 S. W. (Tex.) 447;

Machen v. "The Modern Law of Corporations", Sec. 1088;

Huber v. Martin, 105 N. W. 1031 at 1135;

Donovan v. Purtell, 216 Ill. 629;

In re Rieger, 157 Fed. 609 at 613;

In re Berkowitz, 173 Fed. 1013;

Lunn & Laine Timber Co., v. United States, 196 Fed. 593.

It is, of course, only in equity that a stockholder is ever deemed the owner of corporate property in so far as outsiders are concerned,—and then only in cases where, as in the case at bar, equity looks through corporate form to substance and concludes that the corporate entity is a mere shield to hide the activities of an individual. However, a Court of Equity is quick to sense the true situation.

The case of *Bennett v. Minnott,* 28 Or. 338 at 345, decided by Justice Bean, now of this Court, well illustrates the rule:

> "Under the proofs in this case it is apparent that Minnott was in fact the corporation and the corporation was Minnott. He caused it to be formed, was the president, general manager, treasurer and owned practically all the subscribed stock at the time the pretended transfer was made. He made the contract between himself as an individual and the corporation, acting for both parties, and conducted the business practically the same after as before the incorporation, using the proceeds for his own benefit. Under these circumstances, although the corporation was organized in due form of law and has a valid corporate existence the legal rules which regard it as an entity distinct from the real parties in interest and its stock as property subject to sale under execution must go down in this attempt to consummate a fraud by legal forms. Equity is not bound by the rules of law in this respect when such rules would permit fraud to triumph. 'In equity' says Morawitz, 'the conception of the corporate entity is used merely as a formula for working out the rights and equities of

> the real parties in interest, while at law this figurative conception takes the shape of a dogma and is often applied rigorously without regard to its true purpose and meaning. In equity the relationship of the shareholders is recognized wherever this becomes necessary to the attainment of justice.' Morawetz, Corporations, Sec. 227 and cases cited."

The application of this doctrine to the case of a bankrupt is made in the case of *re Rieger,* 157 Fed. 609 at 613. There a party conveyed property to a corporation which he owned absolutely. He then went into bankruptcy. The Court held that the corporate property was the property of the individual, (exactly as the Court has done in the instant case), and that the Bankruptcy Court, in the exercise of its summary jurisdiction, was justified in ordering the seizure of the property and its delivery to the trustee in bankruptcy.

In the *Reiger* case, supra, the Court says:

> "The fiction of the legal corporate entity cannot be so applied by the partners as to work a fraud on their creditors, or hinder and delay them in the collection of their claims and thus defeat the provisions of the bankrupt act. The doctrine of corporate entity is not so sacred that a Court of Equity, looking through form to the substance of things may not in a proper case ignore it to preserve the rights of innocent parties or to circumvent fraud."

See also,

In re Berkowitz, 173 Fed. 1013.

The principle here involved is graphically stated in *Bank v. Trebein Co.,* 59 Oh. St. 316 at 325, (52 N. E. 834), where the Court says:

> "The corporation was in substance another F. C. Trebein. His identity as owner of the property was no more changed by his conveyance to the company than it would have been by taking off one coat and putting on another. He was as much the substantial owner of the property after the conveyance as before and had substantially the same use of it as if the conveyance had not been made."

But the case of overwhelming authority is the Lunn & Laine Timber Company case, decided by this very Court in 196 Fed. 593. There this Court cites most of the authorities which we have listed above, and announces in decisive language its adherence to the rule for which we contend. To refresh the Court's recollection we will refer to the following language in its decision:

> "If in any conceivable case a Court of Equity should look through form to substance it should do so in a case like this. The corporation is Smith. It is Smith seeking shelter behind articles of incorporation and invoking the legal fiction of a corporate entity for his protection in the perpetration of a fraud."

In the case at bar, appellant's collusion with the bankrupt having been clearly established by the evidence, it is clear that he stands in the same position as the bankrupt and can no more rely upon the corporate fiction than could Buckman.

In all of the cases cited the corporation in quesiton was a properly organized corporation and had regularly issued its stock in consideration of the conveyance to it of the bankrupt's property. In the instant case the facts are even stronger. Sunset Construction Company never issued its stock in consideration of anything ever conveyed to it by anybody. Buckman caused a corporate charter to be issued in the corporate name and then adopted and used that name to cover up his personal transactions. The corporation was never more than a mask,—a thing without substance or property,—and was used by Buckman merely as his other self.

THE MOTION TO DISMISS THE APPEAL FROM THE SO-CALLED "INTERLOCUTORY" DECREE.

The "Interlocutory" Decree is a final determination as to the identity of Buckman and Sunset Construction Company and therefore, no appeal having been taken therefrom within the time allowed by law, all matters covered by said Decree, (save the accounting), have been finally settled and determined as to all parties.

The bill of complainant alleges (Tr. p. 3):

> "That said corporation was organized as a cover for the activities and operations of said A. E. Buckman, and for the purpose of concealing the identity of said A. E. Buckman under the form, and legal entity and name of said corporation. * * * That said organization and formation of said corporation amounted to nothing more than the placing in a corporate form of the capital of said Buck-

man and his abilities as a general construction contractor."

The decree holds (Tr. p. 15.):

> "That A. E. Buckman at all times and up to and on the 19th day of February, 1915, was the owner of the Sunset Construction Co., a corporation, and of all the property, books and records of said company, and that on said last mentioned day said company, property, books and records vested in and became and now are, the property of R. Cords, Jr., as trustee of the estate of A. E. Buckman, bankrupt. * * *"

The allegations of the bill and the evidence fully support the holding of the decree.

If Sunset Construction Company had had even a *de facto existence,* a decree could not have been justified which finds and determines that all of its assets belonged to and should be retained by Buckman's trustee in bankruptcy for the benefit of Buckman's personal creditors. In other words, were the corporation a separate entity, Buckman's trustee would have only been entitled to the stock owned by Buckman, and the corporation would necessarily have continued to own and control its own assets, outside of the Bankruptcy Court. A receiver might, it is true, have been appointed, but his trust would have been for the benefit of Sunset's creditors as distinguished from Buckman,—whereas the decree in this case by its very terms, must be held to obviate that distinction and to

hold that Sunset's creditors were Buckman's creditors, and vice versa.

Therefore, since the decree is without ambiguity on this point, the question of the sufficiency of the evidence to support it was a question for this Court only in case an appeal had been taken in time. Assuming that the decree was equitable or contrary to the evidence, (both of which claims we earnestly dispute), nevertheless these matters were only reviewable on appeal. We therefore regret that we have been forced to enter into an elaborate discussion of an issue which was finally settled for all time in 1916, the year in which the interlocutory decree became final as to all matters thereby determined,—a decree "interlocutory" only in the sense that it provided for the taking of accounts.

The accounting provided for does not in any manner qualify or limit the right of the trustee in bankruptcy to take and hold the assets which are decreed to belong to him.

In *Fogary v. Conrad,* 6 How. 201 at 204, the Court said:

> "The case before us is a stronger one for an appeal than the one last mentioned. For here the decree not only decides the title to the property in dispute, and annuls the deeds under which defendants claim, but also directs the property in dispute to be delivered to the complainant and awards execution. And according to the last paragraph of the decree, the bill is retained merely for the purpose of adjusting the accounts referred to the Master. In all other respects the whole of the matters brought

> into controversy by the bill are finally disposed of as to all of the defendants, and the bill as to them is no longer pending before the court, and the decree which it passed could not have been afterwards reconsidered or modified in relation to the matters decided, except upon a petition for a rehearing, within the time prescribed by the rules of this court regulating proceedings in equity in the Circuit Courts."

See also:

Street on Federal Equity Practice, Vol. II, Sec. 1937 and United States Supreme Court cases cited to the text.

The case at bar is very similar to the case *in re Rieger,* 157 Fed. 609 (approved by this Court in *Lunn v. United States,* 196 Fed. 593), wherein the Bankruptcy Court ordered the Trustee in Bankruptcy to seize the property conveyed by the bankrupt to a corporation which the bankrupt owned and controlled and ordered that, upon the seizure being made, the Bankruptcy Court should adjust the conflicting rights of the individual and corporation creditors. The adjustment of mutual claims is primarily a task for the Bankruptcy Court. But, in the instant case, which was brought in a Court of Equity by the bankrupt's trustee, the Master in Chancery was charged with the task. The District Court might just as well, in the exercise of its discretion, have ordered the Referee in Bankruptcy to perform that duty. Either course was perfectly proper. The accounting was not an integral part of the relief sought by the complainant and is

entirely incidental to the main purpose for which the action was brought.

It is perfectly clear from Judge Van Fleet's oral opinion (Tr. p. 201), that the Court considered the decree a final one:

> "The complaint alleged, as I have indicated, that the property in question belonged to the bankrupt and that for the purpose of concealing it from his creditors, he organized a corporation, in which he held the entire amount of stock, which corporation was organized as a mere cloak under which he managed the property, and that it was his individual property although ostensibly held in the name of the corporation. * * * The decree fully meets the ultimate issues presented by the pleadings; that is that this property, (leaving out the recital of the facts upon which the conclusion is based) was the property of the bankrupt, and when the court decreed that it was the property of the bankrupt it decreed that the evidence sustained the facts alleged in the complaint which warranted that decree. * * *"

The Supreme Court of the United States has held consistently that the title given to a decree shall be disregarded in determining its effect and that if it be in reality a final decree, appeal therefrom must be taken as provided in the statute. It has been held again and again that a decree is final and appealable even though the Court reserves control of the property in controversy pending an accounting between the parties to the litigation.

In *Winthrop Iron Company v. Meeker*, 109 U. S. 180, the decree, having first set aside a conveyance

as fraudulent, thus settling the property rights involved, ordered an accounting of all profits realized by the defendant in connection therewith. At p. 183 the Court says:

> "In our opinion the decree as entered is a final decree within the meaning of Section 692 of the Revised Statutes regulating appeals to this Court. The whole purpose of the suit has been accomplished. The lease * * * has been cancelled. * * * In order that the receiver may perform his duties, the defendants are required to turn over to him the entire property and records of the Company. The accounting ordered is only in aid of the execution of the decree, and is no part of the relief prayed for in the bill which contemplates nothing more than a rescission of the authority to execute the fraudulent lease, or a cancellation of the lease if executed, and a transfer of the management of the affairs of the company * * * to some person to be designated by the Court. The litigation of the parties as to the merits of the case is terminated and nothing now remains to be done but to carry what has been decreed into execution. Such a decree has always been held to be final for the purpose of an appeal."

Obviously, the so-called *"interlocutory"* decree was a final decree, and no appeal having been taken therefrom within the time alllowed by law, Rauer's present attempt to criticise it comes too late, and the appeal therefrom must be dismissed. In any event, this Court must ignore each and all of the points which Rauer attempts to make in connection with the "interlocutory decree", confining its attention to the insignificant matters discussed by

appellant in his brief relative to certain items involved in the accounting.

Rauer's failure to appeal in time from the "interlocutory" decree was neither inadvertent nor due to a misconception on his part as to its meaning.

We have referred to Rauer's present construction of the "interlocutory" decree as "an eleventh-hour contention". It is demonstrated by the record in this case that until the very last he acquiesced in our construction,—the only possible construction of the "interlocutory" decree. Not only did he deliver up the assets of Sunset Construction Company No. 2 in accordance with its directions, but also he later purchased certain of these same assets in the Bankruptcy Court. Clearly, no act on Rauer's part could more plainly confirm our construction of the decree than his purchase in the Bankruptcy Court of the assets of Sunset Construction Company from the trustee of A. E. Buckman, bankrupt. It is difficult for us to see how Rauer could more surely demonstrate his acquiescence in the conclusion of the Court that Buckman's company was a mere shell, than to pay out money to Buckman's trustee for property which could only constitute a valid purchase in the Bankruptcy Court provided Buckman and Sunset No. 2 were identical.

Rauer first undertook to foreclose the chattel mortgage given to secure the notes of the Sunset

Construction Company in the State Superior Court at San Francisco. He says (Tr. p. 279.):

> "I brought an action in the Superior Court of San Francisco to foreclose that chattel mortgage. The defendants gave me a voluntary appearance in that action. It is stipulated that the action was filed June 22, 1916, that the defendants in the action gave a voluntary appearance on the following day, and that on June 24, 1916, a decree was entered in the action by consent of the parties."

The decree witnessed that the personal property given as security under this mortgage, "is now of the value of $7,500", and Rauer credited this amount on the notes secured by the mortgage. Although he later withdrew said credit when the collusive State decree was set aside in the Bankruptcy Court, nevertheless it is significant since it can hardly be supposed that Rauer would have given Buckman credit for anything like the true value of the mortgaged property.

When Judge Van Fleet gave his decree (the so-called "interlocutory" decree) declaring that the personal property secured by the mortgage belonged to Buckman and passed to his estate in bankruptcy, we find Rauer making his petition to the Bankruptcy Court to have a resale of the same property in bankruptcy. (Tr. pp. 282-283.) The petition was granted and upon the resale the property realized only $3,750. (Tr. p. 367.) The property was bought in at bankruptcy sale for Rauer by

another of Rauer's dummies, with the result that he saved some $3,750, by assenting to follow the decree. Thus it is manifest that Rauer readily acquiesced in our construction of the decree when such course was to his advantage,—whereas he now has the temerity to attack the decree, coolly taking a position with reference thereto as inconsistent with his former position as it is unwarranted by the facts.

Rauer's Anomalous Position.

It is plain that the mere fact that Rauer was owed money by Buckman, or his company, can give Rauer no better standing or greater right to the assets of the bankrupt than any other general creditor would have. Obviously, the whole question rests on the determination of a single fact, viz: Were the moneys, which the Master reports due from Rauer to the estate in bankruptcy, assets of the bankrupt which were subject to any Rauer lien? Clearly, they were not, and therefore Rauer cannot complain because he is required to pay them into the bankrupt's estate in order that they may be available to the general creditors.

The argument made by counsel to the effect that no creditor represented by the plaintiff in this case parted with value because of the transactions of Rauer with Sunset No. 2, and that therefore Buckman's general creditors have not been injured by his conduct, is wholly specious. The test of the rights of the general creditors has no such founda-

tion. Their rights are measured by the assets of the bankrupt subject to distribution between them, and Rauer's conduct in draining the bankrupt's estate of these assets through his dealings with Buckman's dummy corporation must inevitably infringe their rights, to the full extent that the bankrupt's estate was depleted.

Moreover Rauer's palpable attempt to make it appear that he has been done a "grave injustice" by the "interlocutory" decree is but another instance of an attempted collateral attack upon it, which must fail for the reason already discussed, viz: The so-called "interlocutory" decree is a final decree as to all matters covered thereby, save the accounting.

If it were possible for Buckman in any way to assign or transfer his assets, whether with or without consideration,—without any sanction, ratification, or confirmation by the Bankruptcy Court,—it would be possible for any bankrupt to deal at his pleasure with his assets, after bankruptcy, in such manner as to deprive his general creditors of any hope of sharing in his estate.

As to the holding in the "Interlocutory" Decree that all of the issued and outstanding stock of Sunset Construction Company was the property of A. E. Buckman and passed to his Trustee in Bankruptcy.

As we have already pointed out, the appellant is in no position to criticise the holding of the "interlocutory" decree on this subject. The decree is

final and was never appealed from as required by law. However, the matter is so strenuously argued in Rauer's brief that we deem it proper that we should point out to the Court the salient fact that appellant has no cause for complaint in this matter, since long prior to the commencement of this action he had parted with any right which he might have had to the stock in question.

We could go into the law and facts fully, and thus show that there was ample justification for the holding of the decree with regard to the Sunset stock. However, detailed analysis of the situation would only prolong this brief beyond reason. Rauer in his answer to the bill alleges affirmatively that the stock in question was pledged as security on a note for $20,000, executed to him by Buckman. He further alleges (Tr. p. 9):

> "On the 12th day of August, 1914, the said defendant J. J. Rauer sold said 10,150 shares of the capital stock of the Sunset Construction Company to satisfy in part the indebtedness to him of the Sunset Construction Company; that said stock was sold for the sum of $50.00 to H. Wehrle and thereafter the said H. Wehrle sold and transferred said 10,150 shares of stock to the defendant J. A. Meadows, sued herein as the defendant John Doe Meadows and the said J. A. Meadows ever since the sale to him of said shares of stock has been the owner and holder thereof."

And, also:

> "Defendants respectfully represent that said shares of stock of Sunset Construction Company now owned and held by J. A. Meadows

have no market value and had no market value at the time of the sale thereof by the said J. J. Rauer to foreclose the pledge thereof as aforesaid." (Tr. p. 12.)

Upon the trial, the fact that the stock was valueless was proved. It was stock in the corporation which lost its charter in 1911. Furthermore, Rauer alleged and later testified flatly and positively that he had sold the stock for the sum of $50.00. (Tr. p. 233.) Even if we assume that the stock in question had real value and even if we assume, further, that the so-called "interlocutory" decree was erroneous in so far as it declared the title to said stock in Buckman's trustee, appellant Rauer can hardly be heard to complain of such ruling. There is not the slightest effort on the part of either Rauer or Meadows, nor is there any testimony in the record given by either of them, to support the view that Rauer ever had, or claimed, any interest in this stock other than as pledgee. Rauer testified that he had foreclosed the pledge under which the stock was held and sold it out to Wehrle for $50.00, and that he had received that sum and still retains it. (Tr. p. 233.) His claim was and is that Meadows acquired it from Wehrle and he testifies positively:

"I did not become the owner of that stock."
(Tr. p. 233)

Obviously, his interest in the stock terminated on the foreclosure sale and no one is in a position to complain on this branch of the case, save Meadows, the alleged purchaser.

The defendant Meadows, has not appealed from the decree and is not before this Court. He has never objected to the decree rendered by the lower Court and he is not objecting to it now. Apparently, owing to the complete lack of any value in the stock, Meadows is indifferent as to its fate. At any rate, Rauer cannot complain of the decree on this score.

A similar question was considered in the case of *Bennett v. Minnott,* 28 Or. 339 at 348, where the decision was written by Bean, C. J.,—now a judge of this Court. In that case it appeared that a merchant had made a fraudulent conveyance of property to a corporation, which conveyance was set aside by the lower Court. The corporation appealed and showed that the merchant's wife had purchased certain of the corporate stock for a good consideration, claiming that this act validated the conveyance to the corporation. It appeared that the wife was a party defendant, but had not appealed from the judgment of the lower Court. Judge Bean disposes of the point in the following language:

> "If this be true, it is not apparent how it can benefit the Hardware Company on this appeal. Mrs. Minott has not appealed and the only question between the Hardware Company and plaintiff is the validity of the sale and transfer by Minott of his stock of hardware to the corporation."

See, also, *Lumn and Laine Timber Co. v. United States,* 196 Fed. 593 at 600, a case decided in this Circuit, where the Court says:

"It is suggested that the fraudulent transfer should be upheld in this case for the reason that a small portion of the stock of the corporation has been purchased by an innocent third party, and that a portion of the stock has been pledged as security for a loan, but it has never been held that a corporation which is not itself an innocent purchaser of property can defend a suit to recover property on the ground that its stockholders subscribed to or purchased their stock in good faith and in ignorance of the fraud. The contrary has been held by this Court in Wilson Coal Co. v. United States, 110 C. C. A. 343."

STATEMENT OF FACTS RELATING TO THE APPEAL FROM THE "FINAL DECREE".

The "final decree" in this case is really nothing more than a decree confirming the report of the Master in Chancery upon the accounts which were referred to him for settlement. The Master took particular pains to adjust these accounts fairly and rendered his original report in draft form so that the parties to this action might have an opportunity to make their respective objections thereto before a final report was rendered. Objections to this draft report were made by Rauer and argued at length and the report was modified in several important particulars. The draft report appears in the transcript at page 19 and following, and the supplemental or final report on page 59 and following. In these reports the Master has carefully detailed the facts regarding the matters in con-

troversy and it would be useless to re-state them at length in this brief. Accordingly we will refer to the Master's report and confine ourselves to such further statements of fact as are required to meet the unfair and misleading allegations contained in Rauer's brief.

Rauer has centered his attack on the items which the Master allowed the Trustee in Bankruptcy as being bills receivable, belonging to the Sunset Construction Company at the time of Buckman's bankruptcy and thereafter collected and retained by Rauer. These items are listed in the Master's Report (Trans. 76) and total $13,023.19. Most of the items pertain to separate transactions.

ITEM OF $5,381.79 BEING ½ FEDERAL CONSTRUCTION CO. PAYMENT.

The report of the Master contains a very full statement respecting this item (Trans. 48-73.) Rauer states that his "main complaint" against this allowance (and the two others discussed next in order), "is that Rauer is not allowed a credit for the alleged rental against the mortgage indebtedness." (Brf. 60.)

The Master bases his allowance of the foregoing item on two grounds (Trans. 50), the first and more important of which is not even mentioned in Rauer's brief. The first ground upon which the Master makes this allowance is, in and of itself,

sufficient to support his conclusion and, if Rauer objects to the conclusion, he certainly should make a showing that the allowance was not justified upon that ground. This he does not even attempt to do and we thus take it that the first ground upon which the allowance is made is impregnable to Rauer's attack.

The second theory upon which the allowance is made is that Rauer used the machinery and equipment of the Sunset Construction Co. as the quid pro quo for the money paid to him as assignee of Buckman, by the Federal Construction Co. This was the machinery which was covered by the lien of the chattel mortgage executed by the Sunset Construction Co. to H. Wehrle (brother-in-law and dummy for Rauer) in June, 1914. (Trans. 279.) This mortgage was given as security for notes aggregating $15,000 and witnessing the same indebtedness as notes theretofore executed to Rauer in the respective sums of $15,000 and $20,000. They were *triplicate* evidences of the same indebtedness. (Trans. 278-9.) On July 22, 1916, Rauer filed a complaint in the Superior Court of San Francisco, to foreclose this mortgage. (Trans. 364.) Buckman had been adjudicated a bankrupt before the complaint in foreclosure was filed, and the very action involved in this appeal was pending at that time. (Trans. 7.) However, Buckman and the other defendants made a voluntary appearance in the action and two days after the complaint was

filed a consent decree was rendered turning the machinery over to Rauer. (Trans. 279.) The decree so made was void against these proceedings and Rauer conceded as much when he petitioned the Bankruptcy Court in December, 1916, to permit him to sell the same property. (Trans. 244)

Appellant assumes that Rauer had possession of this equipment at all times after bankruptcy, but there is nothing in evidence to show that such possession was taken until immediately before the decree of the Superior Court was rendered. (Trans. 364.) He retained possession until title passed to him under sale in bankruptcy in December, 1916.

Moreover, the possession of the equipment which Rauer took was merely colorable for within two months after that possession was secured he executed to Buckman an option agreement wherein he agreed to sell the sand machines to Buckman for $2500, and to credit upon the purchase price "any money received for the use of said machines." (Trans. 370.)

The contract with the Federal Construction Company was fully completed in January, 1916, (Trans. 354) *which was long before the time when Rauer took possession of the equipment* under the chattel mortgage. At that time his mortgage was a mere naked lien unaccompanied by actual possession.

Rauer argues in his brief (p. 63) that he credited moneys received from the use of the mortgaged

machinery upon the mortgage indebtedness. What he actually did appears from his own testimony (Trans. 367):

> "I gave Buckman credit for money received on the San Bruno Avenue job on the general running account."

The Master treats the San Bruno contract as though it were made, in part, to cover the value of Buckman's services. There was some testimony to the effect that the original agreement contemplated certain services being rendered by Buckman but the evidence shows that he actually rendered little or no service and that, so far as there was any real consideration for the contract, it lay in the use of the machinery and equipment which belonged to Buckman's alter ego, the Sunset Construction Co.

S. P. Doyle, cashier of the Federal Construction Co., testified (Trans. 355):

> "Our superintendent reported a number of times that Buckman was not on the job and when we complained about it to Mr. Buckman, he said, 'I have other work to do'."

J. A. Dowling, president of the same corporation, says (Trans. 358):

> "When we started the job originally he (Buckman) started to do a little work there, and we assumed he knew what he was doing. We found out very shortly afterwards that he did not, and we put our own superintendent out on the job, ourselves, to run the work, * * * ."

Rauer recognized these conditions when he asserted his claim as assignee of Buckman for the moneys due to Buckman under this agreement with the Federal Construction Co. and filed a stop notice with the county auditor of the City and County of San Francisco, directing him to withhold from moneys due to the Federal Construction Co. sufficient to satisfy the amount of Rauer's claim. This notice to withhold appears in evidence (Trans. 356) and witnesses the character of the claim made by Rauer, the fact that he is the assignee of Buckman and alleges that the claim is for:

> "the hiring, rental, use and consumption of equipment and material used in the grading and sewering of San Bruno Ave., * * * ."

ITEM OF $1,164.07 BEING RENTAL OF EQUIPMENT ON TARAVEL STREET JOB.

The Master discusses the facts relative to the Taravel Street job in both his draft and supplemental reports. (Trans. 44-66.) The Taravel job was taken in Rauer's name, and he held that contract during the whole time that work was in progress on it. He used the equipment belonging to the Sunset on that job. (Trans. 366.) Accordingly Rauer is charged with the reasonable rental value of the machinery which he used.

But Rauer now complains that the Master refused to allow him the amount of expenditures made by him during that time to keep this equipment in

repair. The Master himself answers this contention very effectively (Trans. 66) and clearly states the reasons why the allowance has not been made.

The Master says bluntly, referring to Rauer's purported vouchers,

> "The numbered vouchers to which counsel refers in his brief are not in evidence."

Neither are they included in the statement on appeal. They are only included in the "observations" or exceptions to the Master's report made by Rauer, a document of his own composition.

The rules of this Court provide that where evidence is offered and rejected (Rule 11) the full substance of that evidence must be quoted in the assignments of error, otherwise the appellant is not entitled to object, on appeal, to the ruling rejecting that evidence. Yet Rauer has not mentioned this rejected evidence in his assignments of error herein, although the same are most voluminous, and he has taken no exception to the ruling.

In this respect we quote Rauer's testimony, (Trans. 368):

> "I could not estimate what I paid out for repairing the sand machines."

He also attempted to establish a bill for $499.40 as a voucher for an expenditure made by him, and the Master, on examining the bill, found that it was nothing more than a receipt for a deposit which was returned to Rauer. (Trans. 369.) So

the Master may be pardoned for refusing to consider unreceipted bills as evidence of payments made by Rauer.

Rauer also claims that he paid $2,200 in royalties to the owner of the patents on the sand machine and infers that Buckman agreed to reimburse him for these royalties. He does not point out any such evidence in the statement upon appeal and we find none there. However, we do find a statement of account between Buckman and Rauer (Trans. 333-334), covering a very considerable period of time, after the date when Rauer took possession of the equipment and *neither repairs nor royalties are billed against Buckman on that statement.* Rauer does claim $1500 for the sand machines and $1000 for the patent rights, which agrees with the amount named as selling price mentioned in the option agreement. (Trans. 370.) This indicates that Rauer himself owned any patent rights that may have attached to these machines and agreed to sell those rights to Buckman for $1000. But there is no evidence to support the claim that Buckman ever agreed to pay royalties to Rauer or anyone else.

That the amount charged Rauer is the reasonable rental value of the machinery appears from the testimony of McCoy and Simmie (Trans. 341-2), and from Rauer's own testimony. (Trans. 366.)

ITEM OF $2,461.13 BEING MISCELLANEOUS COLLECTIONS OF RENTALS.

A portion of the income which Rauer secured from the use of the machinery and equipment mortgaged to him consisted of rentals paid to him by various contractors who rented this machinery from Buckman. There was a great deal of this machinery and Buckman seldom had use for all of it at the same time. Accordingly he was constantly renting it out to others who had use for it and the rentals so secured amounted to a considerable sum. Certain of these rentals were collected by Rauer during the time when Buckman possessed the property, and certain were collected after it passed into the hands of Rauer. Rauer has not segregated the amounts collected during these respective periods and we will not attempt to do so.

Our contention is that Buckman possessed an equity in this machinery which constituted an assignable interest therein,—that this interest passed to the Trustee in Bankruptcy at the time when Buckman was adjudicated a bankrupt—that the collusive decree of the Superior Court under which Rauer took possession of the machinery was void as against the proceedings in bankruptcy and conferred no rights whatever upon Rauer; and that Buckman's trustee was entitled to the rentals received for the use of this machinery up to the time when it was sold under the authority of the Court in Bankruptcy.

ITEMS AGGREGATING $1,607.20 FOR MISCELLANEOUS COLLECTIONS.

These collections are listed as follows (Brf. 70):

Academy of Science	$300.	
Reeder & Foster	407.20	
Bosworth	400.	
Iverson	500.	1,607.20

Rauer argues his objections to these items by mere reference to his own "Observations on Master's Report," which appears in the transcript but which is, in reality, little more than a brief filed by Rauer in the lower Court. In regard to the Academy of Science job he does refer to the statement on appeal (pp. 309, 337, 338, 339), but overlooks any reference to page 374.

The hostile witnesses who were examined upon the subject of this transaction did their best to conceal the truth, but, towards the conclusion of the case, Filmore Buckman testified as follows (Trans. 374):

> "We had a contract with the Academy of Science at Golden Gate Park which was finished *before* bankruptcy. *After* bankruptcy we did some extra work there but the extra work was done for a percentage over cost. The ledger of the Sunset Construction Company shows that J. J. Rauer collected $300 as a *balance upon the original contract.* That had nothing to do with the extra work."

This tells the whole story and shows that Rauer's contention that this $300 was paid for work done

"after bankruptcy" is a falsification of the facts attempted to be made by the confusion of two different contracts.

The misrepresentation of fact in the case of Reeder & Foster (mistakenly called Reeder & Ryder in Rauer's brief), is equally gross. Rauer claims that this was for team hire done four months after bankruptcy. He says:

> "The statement on p. 335 'in full for *Jan.* team hire' is a clerical error and should be *June.*"

This is not so. Rauer's brief entitled "Reply Brief on Accounting," page 49, filed wth the Master, quotes an assignment made of this account as follows.

> "*Jan.* 21, 1915.
>
> For value received we hereby assign, sell, transfer and set over to J. J. Rauer all money due or to become due us from Foster Vogt Co. for team hire, and we do direct said Foster Vogt Co. to pay said moneys to said J. J. Rauer.
>
> Sunset Construction Co.
> By A. E. Buckman, Gen. M."

The Master shows that "Reeder & Foster" is probably another name for Foster Vogt Co., used by Rauer to confuse his account. This assignment is dated *before bankruptcy* and its date is the same as that shown in the ledger of the Sunset Construction Co. (Trans. 335.)

Filmore Buckman testified (Trans. 312):

> "That first item, July 6th, Reeder & Foster, $407.20,—I checked off that first item I think, as being an item which was an asset of the Sunset Construction Company, prior to the date of the bankruptcy. And that is true about the item under date of January 15, 1916, order of Bosworth, $500."

The item of "Bosworth—$400," is explained by the testimony of Filmore Buckman, above quoted. Elsewhere he testified that the Iverson item, $500, covered a bill receivable by the Sunset Construction Company, at the date of bankruptcy, which was not actually collected until after bankruptcy. (Trans. 301.) Rauer admits the truth of this testimony in his exceptions to the Master's report (Trans. 149), where he says in reference to this item:

> "These arose out of work completed by the Sunset Construction Co. previous to February 19, 1915, (the date of bankruptcy), and these accounts were assigned to the defendant Rauer, whether before or after February 19, 1915, does not appear from the evidence, but they were collected by Rauer after February 19, 1915."

If the assignments mentioned by Rauer are not in evidence, who is to blame? The plaintiff here never possessed such assignments but they were given to the defendant Rauer. If Rauer wanted to put those assignments in evidence he had the privilege of doing so, and the inference is that he

didn't put them in evidence because his interests would not be served by such action. The duty was on Rauer to exhibit those assignments or account for their loss. He did neither and cannot complain because of their absence from the record.

ITEMS AGGREGATING $2,409.00 BEING FOR GRADING WORK DONE ON 14th AVE. & B STREET.

The story of the transaction whereby the bills due for a grading contract performed by the Sunset Construction Co. at 14th Ave. and B Street were collected by Rauer and retained by him, is well told by the Master in his report. (Trans. 39-72.)

Rauer in his characteristic fashion, argues his objections to these items by mere reference to the argument made by him in his exceptions to the Master's report. Those exceptions were prepared long before the Statement on Appeal.

Consequently the references made in those exceptions are to the pages of the typewritten transcript prepared by the reporter. Some of this evidence was incorporated into the Statement on Appeal and some of it was not, but in no case can the reference to the typewritten transcript be used in locating evidence incorporated in the printed transcript before this Court. We protest against this method of arguing an appeal as being unfair to counsel and the Court.

The contention of Rauer is that this money was paid to him for paving the street at 14th Avenue and B Street and he affirms that the Sunset Construction Co. had nothing whatever to do with this paving contract. (Trans. 150.) He states further, that the Sunset Construction Co. had finished a *grading* contract on this same street shortly before the *paving* contract was commenced and that the Master has confused the moneys paid under the paving contract with those paid under the grading contract. Rauer concedes (1) that he received the money in question, (Trans. 320-1); that the grading contract was completed by the Sunset Construction Co. before bankruptcy and that the proceeds thereof constituted assets of Buckman, (Trans. 150); and we concede that the moneys paid for the paving work were moneys due to Rauer and was for work done after bankruptcy. The only point at issue is whether these moneys were paid for grading work or for paving work.

Rauer states that his contention is (Trans. 153) that the moneys were paid

> "in payment of Mr. Rauer's bill for paving and not in payment of the Sunset Construction Company's bill for grading; and Mr. Rauer testifies that this is the fact."

Filmore Buckman testified that the "Black Book" contained true entries of all transactions mentioned in it and that "all the entries made by me in the Black Book were transactions of which I had personal knowledge and are correct entries."

(Trans. 295.) If we turn to this book (Trans. 331), we find the following:

"May 25, 1915.	Pd. J. J. Rauer	Ck.	B. Dufau	20.
	"	"	Ryder	306.70
	"	"	Meyer	3148.04
				3474.74
S. C. Co. Ck. taken up	6245			1000.
	6190			1000.
	8256			330.50
	5759			500.
Int.				563.80
				3394.30"

This transaction must be considered in the light of the evidence to the effect that it was the custom of Rauer to take checks to witness the amount due to him from the Sunset Construction Co. and to hold these checks without cashing them (as there was no money in the bank) until such time as they were taken up by payment made direct to him by the Sunset Construction Co. The checks were in reality nothing but a peculiar form of promissory note. The Master describes this method of doing business. (Trans. 25.) Consequently when the Sunset made a payment to Rauer they took, as receipt for that payment, these unpaid checks (or notes) sufficient in amount to equal the amount by which the principal of the indebtedness was reduced. So the foregoing book entry shows that the principal of Rauer's claim against the Sunset was reduced in the amount of $2,830.50 and $563.80 paid upon interest due, by the checks from Dufau,

Ryder and Meyer, which were turned over to Rauer.

The numbers on the checks taken up from Rauer show that these checks were all issued prior to the date of bankruptcy as the number of the check issued on the bankruptcy date was 8631. (Trans. 335.)

Now if Rauer's contention is true and these moneys were paid by Dufau, Ryder and Meyer *upon a paving contract* in which the Sunset had no interest, why did Rauer *apply those moneys in reduction of the principal* and interest of the debt due to him from the Sunset?

The fact that those moneys were so applied by Rauer is conclusive in its effect as proving that they were assets of the Sunset Construction Co. There is no possible explanation which will in any degree mitigate the force of this evidence. If the money had belonged to Rauer he would have appropriated it to his own use without further ado. In his draft report the Master held with us on this contention (Trans. 38-41), but in his supplemental report he reduces the amount which he allows us to the exact sum which we showed, affirmatively, to have been paid for grading work done on 14th Ave., i. e.,

Dufau	$ 20.	
Ryder	245.	
Meyer	649.	$914.

The amounts allowed correspond to the amounts of the bills sent out to these respective parties for the grading work. (Trans. 371-2.)

These bills were dated Jan. 22, 1915, (and following), immediately prior to bankruptcy, and the books of the Sunset show that the money in payment thereof was not collected until after bankruptcy.

Rauer mentions a transaction under date of Feb. 24, 1915, whereby a note from "Ryder" was turned over to Rauer for cash. This refers to an entirely different payment. The transaction upon which we base our claim is that mentioned in the "Black Book" under date of May 25, 1915, and quoted above.

The $495 paid to the Sunset by the City of San Francisco for its proportion of the grading work is explained by undisputed evidence. A bill for this amount for "grading the crossing" on 14th Ave. and B St. was sent out Jan. 6, 1915 (Trans. 372), and on Mar. 10, 1915, the City paid the Sunset the amount of this bill, and the collection so made was "paid over to J. J. Rauer." (Trans. 330.) Nothing could more clearly establish the fact that this was a bill receivable by the Sunset Construction Co. at the time of bankruptcy which was collected thereafter and the moneys paid over to Rauer.

The only other matter to consider is the $1,000 paid by Heyman to Rauer in the form of two checks, one for $750 and one for $250. Rauer admits receipt of these moneys (Trans. 320), but alleges that they were paid to him for work done on the paving contract. Why then did he give the Sunset Construction Co. credit for these amounts in his account just referred to?

It is an admitted fact that these moneys were paid by Heyman for work done on 14th Ave. and B Street. If the money was paid for grading work then it was paid upon an account due to the Sunset Construction Co. at the date of its bankruptcy. If it was paid for paving work then it was paid for work done by Rauer and with which the Sunset Construction Co. had nothing to do. ~~at the date of bankruptcy.~~ Yet Rauer admits in his account (1) that he collected the money, and (2) that he gave the Sunset Construction Co. credit for it on the general account. (Trans. 320.)

There is much other independent evidence to support the conclusion that the money was paid for the grading of the street. Testimony which was uncontradicted showed that the natural order in which street work is done is: first, grading; second, sewering; third, curbing; and last, paving. (Trans. 323.) The same evidence shows that on this particular job the Sunset Construction Co. did the grading, Moran did the sewering, Graham

did the curbing and Rauer employed the Federal Construction Co. to do the paving. (Trans. 323.)

The ledger sheet of Heyman, entitled "O. L. 297, St. Work a/c" (Trans. 325), was introduced in evidence and shows *first* these two payments of $750 and $250 made to "J. J. Rauer & Sunset." Immediately afterwards comes "Edw. C. Moran, sewer", and following "H. Graham." Apparently the paving account is not put on this sheet at all. Heyman appeared as a witness and declared (Trans. 323):

> "On May 21st, I paid $750 and on May 24th I paid $250 to Rauer and the Sunset Construction Co. * * * Those payments were on the 14th Ave. contract. * * * The amounts I have read out as being paid for work on 14th Ave. are for the grading work, the paving is not entered in this account. The paving contracts were entered into with the City Street Imp. Co. or the Federal Construction Co."

Rauer confirms this statement in part by testifying that the Federal Construction Co. was paid $5760 for paving 14th Ave. (Trans. 368.) Because the foregoing statement of Heyman was perfectly clear and consistent with the other evidence in the case the Master accepted it as a true statement of fact. Afterwards Heyman modified his testimony in some very important particulars but the inconsistency was resolved by the Master in favor of the statement quoted above and which is un-

doubtedly the correct statement. Where testimony is conflicting the judge who actually sees the witness on the stand and hears the testimony which he gives is the one who is best fitted to decide which one of the two conflicting statements is closer to the truth.

THE EVIDENCE FULLY SUPPORTS THE FINAL RECREE MADE IN THIS ACTION.

The right of the trustee to take the assets of a bankrupt which belong to him at the time of his bankruptcy are so numerous and decisive that any discussion of such a proposition before this Court would be absurd. That this right cannot be obstructed by the formation of a dummy corporation to hold the bankrupts assets is a proposition of law which has already been fully discussed.

There is, therefore, no necessity of discussing here the law in relation to most of the allowances which were made to plaintiff by the Master as representing bills receivable belonging to Buckman on the date of bankruptcy and thereafter collected by Rauer to the prejudice of the balance of Buckman's creditors.

We shall, however, discuss the special case where the assets so collected represented the income, rental or other consideration for the use of machinery and equipment covered by the chattel mortgage executed by the Sunset to Rauer's dummy, Werhle.

The Trustee's right to the income derived from the machinery and equipment of Sunset Construction Company No. 2.

This machinery and equipment were not sold in the Bankruptcy Court until December 7, 1916. Until that time title remained in Buckman's trustee. It therefore, follows that the rents and profits of the mortgaged property, accruing prior to the sale, were part of the estate in bankruptcy and must be distributed to the general creditors. For it was not until the sale in bankruptcy that the mortgagee secured title.

See *In re Brose,* 254 Fed. 664 and authorities hereinafter cited.

The filing of the petition in bankruptcy operated as a caveat and injunction against the entire world, and all property then possessed by the bankrupt or held for him by any third person, became a part of his estate in bankruptcy. This doctrine has been established by the Supreme Court of the United States in a series of decisions:

See *Mueller v. Neugent,* 184 U. S. 1;
Watts v. Sachs, 190 U. S. 1;
United States Fidelity Company v. Gray, 225 U. S. 205.

In the instant case, the evidence shows that when the petition in bankruptcy was filed, Sunset Construction Company No. 2 owned and possessed the machinery and equipment covered by the chattel mortgage executed in Rauer's favor. At that time, however, the Sunset claimed to be an adverse

claimant and, under the circumstances, the trustee was not in a position to forcibly seize the assets so held. Later, however, it was established, in effect, by the Interlocutory Decree, that the Sunset was not an adverse claimant but was then, and had been theretofore, a mere sham,—a fictitious alias for Buckman; that the property possessed by it was Buckman's property and that its possession was his possession.

The necessary consequence of this holding was that title to this machinery and equipment was established in Buckman's trustee in bankruptcy as of the date of the filing of the petition in bankruptcy.

To the general rule see:

Collier on Bankruptcy, 11th Edition, pp. 526-7;

Loveland on Bankruptcy, 4th Edition, §§57 and 410;

Murphy v. Hoffman Co., 211 U. S. 562;

White v. Schloerb, 178 U. S. 542.

The same rule covers the income derived from the machinery and equipment during the bankruptcy period. The situation with which we are immediately dealing is controlled by the law of contracts as it exists in this state and the rule governing the case must be ascertained from the decisions of its Courts. These decisions hold that the increase of profit or income from mortgaged

personal property does not pass to the mortgagee unless the mortgage itself expressly so provides.

In *First National Bank v. Errecca,* 116 Cal. 81 at 83, a chattel mortgage was placed upon a band of sheep and the question arose as to whether the wool grown on the sheeps' backs and the lambs in gestation at the time the mortgage was executed belonged to the mortgagor or to the mortgagee. The Court held these profits the property of the mortgagor as they were not covered by the terms of the mortgage. Judge Van Fleet, then on the State Supreme Court Bench, concurred in the decision.

See also:

Shoobert v. De Motta, 112 Cal. 215;

The decisions in the above cases are in accordance with the general rule.

The extent of the liability of a *mortgagee* is stated in 11 C. J. 561 as follows:

> "While the right of redemption exists, a mortgagee in possession is liable to account for the income, profits and proceeds of the mortgaged chattel, and, if the nature of the property permits, he is bound to exercise reasonable diligence in keeping it employed."

It also appears from a case in the foot note to the above citation that, when a mortgagee takes possession, he is considered in equity in the light of a trustee and is accountable for the use and profits of the mortgaged property.

See also:

Mahoney v. Bostwick, 96 Cal. 54.

In *Rodriquez de Cazara v. Orena,* 80 Cal. at 32, the syllabus, sustained by the text, reads as follows:

> "A mortgagee, if he has been in possession of the mortgaged premises, or has received the rents and profits, must account for them or the value of the use and occupation."

See also:

Bank of Woodland v. Heron, 120 Cal. 614.

In *Simpson v. Ferguson,* 112 Cal. 184, 53 Am. St. Rep. 201, the Court quotes section 670 of Jones on Mortgages as follows:

> "Even if the rents and profits of the mortgaged property are *expressly pledged for the security of the mortgage debt, with the right to take possession upon default,* the mortgagee is not entitled to the rents and profits until he takes possession, or until possession is taken in his behalf by a receiver." (Italics ours.)

In *Kountze v. Omaha Hotel Co.,* 107 U. S. 378, the Supreme court of the United States say:

> "In the case of a mortgage, the land is in the nature of a pledge; and it is only the land itself,—the specific thing—which is pledged. The rents and profits are not pledged; they belong to the tenant in possession, whether the mortgagor or a third person claiming under him * * * . The taking of the rents and profits prior to the sale does not injure the mortgagee, for the simple reason that they do not belong to him."

See:

Simpson v. Ferguson, supra and cases there cited;

Guy v. Ide, 6 Cal. 99; 65 Am. Dec. 490;

West v. Conant, 100 Cal. 231;

Freeman v. Campbell, 109 Cal. 360;

Wagar v. Stone, 36 Mich. 364;

Hardin v. Hardin, 34 S. C. 77; 27 Am. St. Rep. 786.

Thus it will be seen that, even in case the mortgagor permits the mortgagee to take possession upon default, unless and until the mortgage is lawfully *foreclosed,* the mortgagee has no lien upon the rents and profits of the mortgaged property. Clearly, all rents and profits derived by Rauer from the machinery and equipment involved in this case, accruing prior to December 7th, 1916, the date of the sale in bankruptcy,—are payable to plaintiff for pro rata distribution among the general creditors.

The possession which Rauer took of the property was subsequent to the time when Buckman was declared bankrupt and was without permission of the Bankruptcy Court. It was, accordingly, unlawful and in derogation of the jurisdiction of that Court.

Collier, "Bankruptcy," 13th Ed., Pg. 803:

> "A state Court has no jurisdiction to foreclose a mortgage on the bankrupt's property

> after bankruptcy has intervened without leave of the bankruptcy court and making the trustee a party."

Certainly Rauer has no right to do what the state Court cannot do, and his attempt to possess himself of the mortgaged chattels belonging to the bankrupt without notice to or authority from the Bankruptcy Court cannot confer upon him any title to the rentals received by him from letting out the property so seized. Rauer got his first and only authority to possess himself or this property in December, 1916, when it was sold to his dummy, upon his petition, by order of the Bankruptcy Court. He is bound to account for all rents received by him up to that time.

In claiming, as counsel do, at p. 67 of their brief, that the law requires a mortgagee to apply all rents, etc. received from the mortgaged property on the mortgage debt, counsel completely lose sight of the fact of Buckman's bankruptcy and the consequent right of the general creditors to share in proportion to their claims. Also, the rule mentioned by counsel can only apply to cases where the mortgagee is in *lawful* possession of the mortgaged chattel.

Where the mortgagee takes lawful possession of the mortgaged chattel before the foreclosure of the mortgage, some decisions hold that he is entitled

to apply the amount of the income to the liquidation of the mortgage debt. In order to possess this right however, he must be in *lawful* possession of the property and actually apply the amount received on the secured indebtedness. Rauer has not made any showing in this case of either of the foregoing essentials. During the short period during which Rauer had any possession of the property his possession was exceedingly colorable and really for Buckman's benefit, as the option executed to Buckman plainly shows. (Tr. p. 370) Furthermore, in every case where Rauer collected money from the rentals of the mortgaged chattels he applied the amounts collected to the *general,* and not to the mortgage account. (Tr. p. 367.)

CONCLUSION.

The case at bar has been pending since Oct. 27, 1915. The appeal from the final decree was taken by Rauer more than a year ago. Rauer has been granted most extraordinary indulgence to present and argue objections. He argued the case when it was submitted to the Master; he argued it again after the Master had made his draft report, and the Master then resolved every possible doubt in favor of Rauer, (as appears from a comparison of his draft and final reports.) After the Master submitted his final report Rauer re-argued the case

before the Master and again before Judge Van Fleet. Both the Master and Judge Van Fleet were of the opinion that Rauer has profited illegitimately as a result of his unfair tactics in covering up the assets of the bankrupt. The Master says (Trans. 38), referring to him:

> "The funds have been so mixed by him and there are so many items of doubt and so much in evidence to show that more of the prior assets have been received by Rauer, etc."

And Judge Van Fleet says (Trans. 202):

> "The Master, I think, if he committed any error, committed it against the parties prevailing as to the extent of the accounting required."

The labor of meeting Rauer's persistent objections and innumerable obstructions has been monumental. For eight years he has retained the moneys unlawfully collected by him and has been charged with legal interest thereon only since December, 1921. Yet the record here shows that he lends money at usury and ordinarily receives 2% a month as interest. It is safe to say that these delays and obstructions have profited Rauer mightily.

We believe that this appeal was taken as part of appellant's studied program to exhaust the complainant with endless litigation.

We think it is high time that the penalty of appellant's devious methods should be brought home to him.

Dated, San Francisco,
November 10, 1923.

Respectfully submitted,

EDWIN H. WILLIAMS,
CHARLES S. WHEELER, JR.,
Attorneys for Appellee,
George H. Hatfield, as Trustee in
Bankruptcy of the Estate of
A. E. Buckman, Bankrupt.